92-683

Supreme Court, U.S.
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No.

IN THE

Supreme Court of the United States

October Term, 1992

DOUGLAS J. ERATH, *Pro Se*,
Petitioner,

against

XIDEX CORPORATION, *et al.*,
Respondent.

On Petition for Writ of Certiorari
to the United States Court of
Appeals for the Ninth Circuit

PETITION FOR A WRIT OF CERTIORARI

DOUGLAS J. ERATH
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Question Presented

Whether the Magistrate in the Advisory Opinion has constructed certain parts of Section 18(a), Section 201.4-01, Section 29(b) and certain SEC regulations in conflict with the non-ambiguous wording of these regulations and with certain expressed holdings of the U.S.Supreme Court, several Circuit Courts of Appeal, and the SEC thereby failing to conform to the need for uniformity in the administration of Federal securities regulations.

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To The Honorable Chief Justice and the Associate Justices of the Supreme Court:

Douglas J. Erath, pro se, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit in this case.

Opinions Below

The Advisory Opinion of the Magistrate for Summary Court trial was entered 6/13/90 (App. A, infra, a1-a59). The order by the district court granting motion for summary judgment was entered 2/07/91 (App. B, infra, a60-a61). The judgment of the district court that defendants' motion for summary judgment is granted was entered on 2/07/91 (App. C, infra, a61-a62)

Jurisdiction

The Court of Appeals affirmed the district court order filed 2/07/91 on 5/01/92 (App. D, infra, a62-a63. Rehearing was denied on 7/01/92 (App. E, infra, a63-a65). The jurisdiction of this Court is invoked under U.S.C. 1254(1).

Constitutional and Statutory Provisions Involved

There are no constitutional provisions involved. The statutory provisions have

been listed in the TABLE OF AUTHORITIES and, in pertinent part, have been placed in the appendix.

Statement

This action arises from the purchase of 112,000 Xidex Corporation Warrants by petitioner on various dates commencing on 12/17/1986. Petitioner had read favorable reports on the company and its management. At his request, Xidex sent him a copy of the 1986 Annual Report to Shareholders. On the basis of these reports petitioner purchased both common shares and warrants. The specific basis for investing in the warrants was the "warrant description" in Note 2 of the Notes to Consolidated Financial Statements on p. 18 of the 1986 Annual Report (App. R, infra, a74-a75). P. 18 was part of the Consolidated Balance Sheets which were accepted with no waivers by the auditors. Petitioner noted

this and alleges that he relied fully upon the truth of the "warrant description".

On July 29, 1988 Xidex merged with Anacomp on the basis of $9.25 for the common. By exercising certain adjustment conditions which had been required to have been described by SEC regulations and had been omitted, the warrants became convertible to $9.25 stock by paying $20.415. Therefore, whereas petitioner made several profitable transactions with the common during this time span his warrants became valueless.

Petitioner avers that he directly relied upon the statements he had read in a document that was "filed" at the time he read them. He does not claim that he knew at the time of purchase that the document was filed. He relied on the truth of the contents of the statements in the document and would not have purchased the warrants if he had known about the provisions.

The Magistrate's Advisory Opinion (App. A, infra, a1-a59, "hereafter a1-a59")

Amongst other opinions, the following have been expressed by the Magistrate on the pages indicated.

1. Section 18(a) Reliance

[p. 18], a31-a32,

Plaintiff's argument serves to point out that other courts have not specifically ruled that a person must have knowledge that the document relied on is a filed document prior to purchasing securities. Nevertheless, it is the opinion of this Court that plaintiff must show that he knew at the time he purchased the Warrants that the document he was relying on was filed with the SEC in order to prevail under §18 (a). The Court arrives at this opinion based on the reasoning that "it is the knowledge that it has been filed with the Commission that justifies reliance on the document" Wachovia, at 1006, n.13.

On [p. 18], a32-a33,

Defendants further rely upon Bromberg & Lowenfels, IV Securities Fraud and Commodities Fraud, §8.4(469) (1989) for the proposition that in order for plaintiff to state a case under §18(a), he must plead: (1) that he knew that the document relied upon was filed with the SEC, and (2) that he did not know that it was false or misleading when he bought or sold in reliance on it. Clearly plaintiff has failed Bromberg's first test,...

2. "In Toto" - Incorporation by Reference

The Magistrate states on [p. 8],a14, "Once incorporated into the 10-K, the note from the financial report portion of the Annual Report became united or submerged into the rest of the 10-K and hence the 10-K "in toto" must be looked to for liability under §18(a)."

3. Misleading - Material

On [p. 13] a23, the Magistrates states: "This Court is of the opinion that plaintiff has failed to show that "in the light of the circumstances" the omission of the Adjustment Provisions from Note 2 was false or misleading with respect to a material fact." The justification for the "in the light of the circumstances" was the argument by defendants that Note 2 was entitled "Acquisitions", not Warrants and that "[t]he details of the Warrant Agreement omitted from the Note were not, according to the defendants, material to

the topic of the Note concerned, namely "Acquisitions"."

4. Purchase or Sale

The Magistrate stated on [p. 22] a39, "Defendants, however, correctly point out that under §18(a) the price plaintiff paid must have been affected by the misleading statement, Ross, at 551, and in the instant case that just is not true."

5. "Good Faith"

On [p. 28]a49-a50, the Magistrate agrees with defendants' argument that the warnings in the Warrant Agreement and the warrant certificates are evidence of their "good faith" by informing the marketplace of the Adjustment Provisions.

6. Section 29(b)

On [p.31] a55-a56, the Magistrate contends that he alleged omission of the Adjustment Provisions is collateral to the Warrant Agreement and thus not actionable in Section 29(b) rescission.

Reasons for Granting the Writ

Petitioner believes that the Magistrate has constructed certain parts of federal securities regulations in direct conflict with certain holdings of the U.S. Supreme Court, the Second, Fifth, Eighth, Ninth, Tenth and D.C. Circuits as well as specific SEC Regulations necessary to enforce securities laws.

In a federal system a non-ambiguous law or regulation must be constructed with uniformity. When lower courts decide cases in conflict with these laws and the precedents set by Circuit Courts, then it is incumbent upon the Court to exercise its supervisory power and re-establish federal uniformity by resolving these conflicts.

The Court has rarely, if ever, provided clarifying exposition on the merits of a §18 case. Petitioner believes that in the instant case important questions of statutory construction have been decided by

the Magistrate, which have not been, but should be decided by this Court. §18 has had limited usage. It is timely for the Court to explain its proper place in the Acts of 1933 and 1934. Justice Harlan, in dissent, stated in The Monrosa v. Carbon Black, Inc. 359 U.S. 180,185 (1959), "Moreover, review by certiorari, as Chief Justice Hughes once put it, is "in the interest of the law, its appropriate exposition and enforcement, not in the mere interests of the litigants."

Petitioner will support his arguments regarding conflicts by commenting upon the opinions listed in the Advisory Opinion (pp. 5-7), supra.

1. Section 18(a) Reliance

Ernst & Ernst v. Hochfelder, 425 U.S. 185, 200-01 (1976) states:

> Ascertainment of congressional intent with respect to the standard of liability created by a particular section of the Acts must therefore rest primarily on the language of that sec-

> tion... , and mindful that the language of a statute controls when sufficiently clear in its context, United States v. Oregon, 366 U.S. 643,648 (1961);..."

The Magistrate does not claim, as Ernst, supra, stipulates, that the language of §18 (App. F,infra, a65) requires the prior filing knowledge. The language of §18 in no way states or implies the prior filing knowledge requirement. Authorities only require that the statement(s) of the filed document be relied upon. They may discuss direct versus constructive reliance but always with reference to the statement(s). In Ernst, supra, p. 211, the Court states, "Under §18 liability extends to persons who, in reliance on such statements,..."

In Fischman v. Raytheon Mfg. Co., 188 F. 2d 783,788 (2d Cir. 1951), the Second Circuit did not require prior knowledge of filing, "Accordingly, the common stockholders may also maintain their action under that section [§18(a)] if (but only

if) they amend to allege a filing with a national securities exchange."

In Ross v. A.H.Robins Co. , 607 F. 2d 545, 552 (2d Cir. 1979) the Second Circuit, again, makes no requirement for prior knowledge of filing, "Section 18 requires that a plaintiff establish knowledge of and reliance upon the alleged misstatements contained in any document filed with the SEC..."

The D.C. Circuit which reviewed the very Wachovia case cited by the Magistrate as the primary authority for the prior knowledge requirement directly contradicts this theory. Wachovia Bank & Trust v. National Student Marketing, 650 F. 2d 342,357 (D.C.Cir. 1980) states:

> "Section 18 makes any person filing a "false or misleading" statement with the SEC liable for damages caused by reliance on that statement."
> ..."Section 18 therefore requires that plaintiffs prove actual reliance on particular filed statements,..."
> "Under Section 18, a plaintiff need only show that a filed document contains

> a material omission or misstatement and that he relied on that document..." (Emphasis supplied.)

The Magistrate, on [p. 18], a32, bases the opinion on the reasoning that "it is the knowledge that it has been filed with the Commission that justifies reliance on the doctrine," Wachovia, supra. But this quote has been taken out-of-context from Note 13 which states on p. 1006:

> "It is unclear whether reliance must be on the actual document filed with the SEC, or whether reliance on a copy of such document would suffice. The latter seems to be the more reasonable position since it is the knowledge that it has been filed with the Commission that justifies reliance on the document." (Emphasis supplied.)

The clause, "since it is ... document", is by its grammatical form designed to support the "latter" argument. But, the "latter" is merely a condition whereby reliance on a copy of such document would suffice. Taken in context this is quite different from the Magistrate's implication that the "since" clause refers to

the need of prior knowledge of filing as a reliance requirement. In reference to Note 13 it is stated on Wachovia p. 1000:

> 3. Securities Regulation 122
>
> In order to establish violation of statute proscribing filing of fraudulent documents with the Securities Exchange Commission, reliance on copy of such documents rather than actual document itself will suffice....

Finally, petitioner discusses the other major support claimed by the Magistrate: the Bromberg quote. In Bromberg & Lowenfels, IV Securities Fraud and Commodities Fraud, 1989 on §8.4(467),(App. U,infra, a 76-a77), Professor Bromberg states:

> Another aspect of plaintiff's knowledge is important. He can maintain suit only if he bought or sold in reliance on the false or misleading filing. Therefore he must know of the filing. Presumably this means know of the information in the filing. (Emphasis supplied.)

On §8.4 (469) (App. U. supra), it states:

469 Pleading. A plaintiff employing SEA §18(a) should plead

(1) He knew of the filing which was

false or misleading (as a basis for relying on it) and ...

By combining 469(1) with 467 we have (1) He knew of [the information in the filing] which was false or misleading (as a basis for relying on it) and...

But the Magistrate has written on [p. 18] a33, "(1) that he knew that the document relied upon was filed with the SEC, and ..." Clearly this representation of Bromberg (1), so vital to the Magistrate's opinion, is not well grounded in fact.

2. "In Toto" - Incorporation by Reference

Item 8 of p. 13 of the 1986 Xidex 10-K (App. S, infra, a75) incorporates by reference most of the second half of the Annual Report. This includes p. 18, the page on which the alleged warrant description is written. Reg. §14c-3(b) (App. I, infra, a67-a68) establishes that due to the specific request of Xidex in their incorporation by reference, the p. 18 warrant

description is "filed" and subject to the limitations of §18(a).

Petitioner claims that the part of the Annual Report upon which he relied has been deemed "filed" and is subject to §18 (a) "in isolation" from the entire 10-K. The Magistrate contends on [p.8] a14,"Once incorporated into the 10-K, the note from the financial report portion of the Annual Report became united or submerged into the rest of the 10-K and hence the 10-K "in-toto" must be looked to for liability under §18(a)."

This would require the Annual Report which was written under §14 rules to be judged by the §13 rules of the 10-K. With foresight, in the Federal Securities Law Reports, CCH 1989, FORM 10-K ¶31,102 (App. J, infra, a68-a69), the SEC has established under "G" that incorporation by reference of an annual report into a 10-K can only be done "provided such annual report

contains the information required by Rule 14a-3." Therefore by SEC regulation the warrant description is to be judged for compliance "in isolation" as a pre-condition to incorporation by reference and not under any "in-toto" condition.

Reg.§14a-3(b)(1) (App. K,infra,a69) requires the registrant to prepare in accordance with Reg. S-X (Part 210)(App.L,infra, a70). Therefore the pre-condition for incorporation is compliance with Reg. S-X.

The wording of §18(a) supports this view "...which statement was at the time and in the light of the circumstances under which it was made..." (Emphasis supplied.)

3. Misleading - Material

Rule 14a-3 (App. K,infra, a69) requires the registrant to prepare in accordance with Reg. S-X (Part 210) (App. L,infra, a70). Part 210 contains, et alia, Reg.§210.4-01 (App. G,infra, a66) and Reg.§210.4-08 (App. H,infra, a66-a67). Reg.§210.4-01(a) states,

"...The information required with respect to any statement shall be furnished as a minimum requirement to which shall be added such further material information as is necessary to make the required statements, in the light of the circumstances under which they are made, not misleading"...

(1) Financial statements filed with the Commission which are not prepared in accordance with generally accepted accounting principles will be presumed to be misleading or inaccurate, despite footnote of other disclosures, unless the Commission has otherwise provided. ... (Emphasis supplied.)

The Magistrate accepts defendants' argument on [pp. 12-13] a22-a23, that "in the light of the circumstances", namely the fact that the Note was headed "Acquisitions" and not "Warrants", the omission in question was not false or misleading. But these very "circumstances" include the legal requirement to comply with SEC regulations. There was only one "warrant description" in the Report. Was this description made to comply with Reg. S-X (Part 210) or was it not? If not, then Xidex violated SEC rules by omitting compliance

If so, then the "warrant description" under heading "Acquisitions" is the only possible compliance and failure to meet the requirements of §210.01(a) is illegal.

The SEC has specifically stated that requirements must be met regardless of format. Reg.§14a-3 (App. K, infra, a69) establishes the requirements of meeting Reg. S-X (Part 210) provisions in b(1). Later, in b(11) it states: "Subject to the foregoing requirements, the report may be in any form deemed suitable by management.." (Emphasis supplied.)

The "despite footnote of other disclosures" of §210.4-01, supra, combined with the many court decisions on "due diligence" and "curing" refute compliance arguments by the Magistrate based on Warrant Certificates, Warrant Agreement, etc. Compliance must be on the face of the document in question. See, Johnson & Staley v. Bushan & Levy P.C., 527 F. Supp.

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1159,1162 (S.D.N.Y. 1981), Holdworth v. Strong, 545 F. 2d 687,694 (10th Cir.1976), Spatz v. Borenstein, 513 F. Supp. 571,579 (N.D.Ill E.D. 1981), Stier v. Smith, 473 F. 2d 1205,1208 (5th Cir. 1973), Dale v. Rosenfeld, 229 F. 2d 855,858 (2d Cir.1956).

With regards to materiality, petitioner requests the Court to read the omitted warrant adjustment provision, WA 11,(App. Q,infra, a72-a73). Any of four provisions, if invoked under certain price conditions, could lead to a total loss of the warrant investment and the consequent removal of a $17,411,000 liability of Xidex.

It must be found by the Court that the warrant holders were entitled to explicit disclosure of the material risk involved herein so that they could consider this factor in determining whether they wanted to buy or sell the warrant.

Petitioner has contended on [pp. 27-28] a49, that the warnings on the Warrant

Certificates regarding the adjustments indicates that Xidex considered the topic important (material). We do not warn the marketplace of unimportant factors. Petitioner has established in previous briefs that prior to the warrants becoming valueless he had never received or seen a Xidex warrant certificate since his account was in "street" name.

Lastly, in a technical sense, the SEC has identified under a §12 registration requirement, Reg. S-K (Reg.§229.10) (App. M, infra, a70) the Reg.§229.202(c) (App. N, infra, a71) which states in part: ...

"(4) Provisions for changes to or adjustments in the exercise price, and
(5) Any other material terms of such rights or warrants."

The warrant description requirement in the §12 Reg. S-K registration is designated to be for a non-financial statement. The warrant description requirement in Reg. S-X (Part 210) is designated to be

for a financial statement. Petitioner does not claim that Reg. §229.202(c) is a stated requirement under §14. He does however cite a SEC regulation and a ruling by the Eighth Circuit that indicates that what has been deemed "material" by the SEC under §12 will remain "material"under §14. Reg.§240.14a-1 (App. P,infra, a72) states, "Unless the content otherwise requires, all terms used in this regulation have the same meaning in the Act or elsewhere in the general rules and regulations thereunder..." Austin v. Loftsgaarden, 675 F. 2d 168,179 (8th Cir. 1982) states, "As previously stated the materiality standard is the same under all the securities statutes."

The compelling argument by petitioner for materiality remains, as stated, the substantial likelihood that a reasonable investor would have attached importance to the omitted adjustment provisions in

determining whether to buy or sell the warrants.

4. Purchase or Sale

Whereas §18(a) states "purchased or sold", the Magistrate seems only to consider the purchase price. It is stated on [p, 32] a47, "but obviously plaintiff has failed to carry his burden of showing the price he paid was affected by the omissions,..." Petitioner has repeatedly stated that it is not the purchase price that is a factor in this case but it is the "sales price" that meets Section 18(a) requirements. The "forced sale" doctrine applies in the instant case.

Petitioner has included in the appendix (App. T, infra, a75-a76) pertinent parts of a letter from Nancy K. Frank, Xidex Corporate Counsel, in which it is acknowledged that the warrants became valueless as a result of Xidex invoking a term in the Warrant Agreement. This term had been

omitted in the warrant description and its invocation is the proximate cause of the loss.

On p. 9 of the Warrant Agreement (App.Q infra, a73) it states, "An adjustment made pursuant to this paragraph 11(a) shall become effective immediately the effective date of such event retroactive to the record date, if any, for such event..."

The foregoing means that, by the action of Xidex on July 29,1988, the warrants became worthless at that time. No act of volition was required of the warrant holders; the action was "automatic". This results in a "forced sale" as shown by the following cases: Vine v. Beneficial Finance Company, 374 F. 2d 627,634 (2d Cir. 1967); Mader v. Armel, 402 F. 2d 155,160 (6th Cir. 1968); Mosher v. Kane, 784 F. 2d 1385,1389 (9th Cir. 1986).

Weisman v. Darneille, [1977-78 Transfer Binder] CCH Federal Securities Law Re-

orts ¶96,278 at 92796-7 (S.D.N.Y. 1978) states that the forced seller doctrine applies in a Section 18 damages action by "applying to Section 18 the broad definition of "sale" and "purchase" applicable to a Section 10(b) action."

5. "Good Faith"

The "good faith" defense is not used to argue that liability has not been established as the Magistrate attempts on [pp. 27-29,] a47-a51,. It is employed, if and only if, liability has been established up to this point. Otherwise it would not be needed. The requirement is for defendants to prove that they had no knowledge that such statement was false or misleading. But they did! (1) Defendants wrote both the Warrant Agreement and the allegedly misleading warrant description. (2) §210.4-01(a) required a description of the terms of the warrants in a prescribed way that was not met. Defendants were re-

sponsible for this knowledge. On p. 4 of the Warrant Agreement it provides that the rights of the warrant purchaser are subject to the provisions of the Warrant Agreement. (4) The warnings on the warrant certificates indicate that the warrants are subject to the terms and conditions of the Warrant Agreement.

This overwhelming evidence establishes that the defendants had absolute knowledge that the adjustment provisions were important and that they had been omitted from the "warrant description". Therefore, there is no "good faith" defense.

6. Section 29(b)

On p. 21 (App. Q, infra, a73) the Warrant Agreement states: "Section 25. California Contract. This Agreement and each Warrant Certificate issued hereunder shall be deemed to be a contract...."

Therefore, by defendants' own stipulation both the Warrant Agreement and the

sale (each issuance of a certificate) are deemed to be contracts. It is also conceivable that the sale could be considered the "performance" of the warrant agreement contract.

Petitioner does not claim that the Warrant Agreement is by its own terms illegal. He claims that if a violation of § 210.4-01 or §18(a) is established then the purchase contract by him of the warrants which was induced by the omission meets the liability requirements of §29(b) (App. O, infra, a71-a72). Support comes from Regional Properties v. Financial & Real Estate Consulting Co., 678 F. 2d 552,561 (5th Cir. 1982) and Slomiak v. Bear Stearns & Co., 597 F. Supp. 676,682 (S.D.N.Y. 1984).

The Magistrate contends that the omission is "collateral" to the Warrant Agreement but fails to consider the sale in itself to be a contract. The Second Circuit

in Kaiser-Frazer v. Otis & Co., 195 F. 2d 838 (2d Cir. 1952) states in a related case: "...The prospectus, which has been found to have been misleading, formed an integral part of the contract and the public sale of the stock by the underwriter was to be made and could only have been made in reliance on that prospectus...."

Petitioner contends that his purchase contract of the warrants was based, in large part, on the "warrant description" and had the pertinent parts of the adjustment provisions (of which he was totally unaware) been disclosed he would not have entered into the contract. This is not a "collateral" issue.

Conclusion

Petitioner believes that material and irreconcilable conflicts have been demonstrated. These conflicts affect the enforcement by the courts of the expressed will of Congress in enacting the disclos-

ure regulations of the Acts. The tremendous range of the conflicts show that the correct interpretation of §18 is an area of the securities laws badly in need of the Court's authoritative voice. It is, therefore, timely that the conflicts be resolved by explicit decision of the Court.

Such resolution will (1) clarify Congressional intent with respect to certain federal securities regulations and (2) exercise the Court's supervisory powers in emphasizing the need to follow certain procedures with respect to non-ambiguous regulations, Circuit Court precedents and SEC Regulations so as to achieve federal uniformity in the enforcement of federal securities laws.

The petition for a writ of certiorari should be granted.

Respectfully submitted,

Douglas J Erath

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September 21, 1992

APPENDIX

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APPENDIX A

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF ARIZONA

DOUGLAS J. ERATH,

Plaintiff, No. CIV-89-198-TUC-ACM (NF)

vs.

XIDEX CORPORATION, ET AL., ADVISORY OPINION

Defendants.

This case was referred to the United States Magistrate for Summary Court Trial upon the consent of the parties and pursuant to the Court's pretrial powers and inherent power to control its docket. The matter came on for a Summary Court Trial on Tuesday, April 17, 1990, and as requested in the Joint Report of the Parties Pursuant to Rule 16 of Federal Rules of Civil Procedure [hereafter Joint Report], the Court renders the following advisory opinion as to the viability of the plaintiff's case:

OPINION

This action arises out of the purchase of 112,000 Xidex Corporation Warrants [hereafter Warrants] by plaintiff at various dates commencing on December 17, 1986. Plaintiff uses a discount broker to execute orders and maintain his accounts; he forms his investment strategy by reading the Wall Street Journal, the Wall Street Transcript, Forbes, Infoworld, certain providers of stock market charts and fin-

[1]

ancial books. Plaintiff records price data daily on approximately 50 stocks, maintains daily charts on many of these, is on the mailing list for annual reports of many corporations and frequently checks on the progress of corporations by means of telephone calls to executives.

Xidex Warrants first came to plaintiff's attention in early 1986 while plaintiff was charting Xidex common stock [hereafter

Xidex] and its management. In early October 1986, plaintiff received the 1986 Annual Report to Shareholders mailed to him by Xidex and learned from Note 2 "Acquisitions" [hereafter Note 2] of the Notes to Consolidated Financial Statements on page 18 of this report that the strike price of Xidex Warrants was $20.415 and that the expiration date was April 16, 1993 or earlier if the average closing price of Xidex exceeded $30.62 for 180 consecutive trading days. No other qualifications as to the Warrants was expressed in that Annual Report, and plaintiff alleges that he decided to invest in both Xidex Common and Xidex Warrants after reading the Annual Report.

Page 18 of the 1986 Annual Report to Shareholders was part of the Consolidated Balance Sheets of Xidex which were accepted with no waivers by the auditors as presenting fairly the financial position of

Xidex as of June 30, 1986. Plaintiff noted this and alleges that he relied fully upon the terms given for Xidex Warrants.

[2]

On October 27, 1986, plaintiff bought 2,000 shares of Xidex Common at 13 1/4 for $26,600 and 5,000 Xidex Warrants at 3 3/8 for $17,080. He sold these four days later on October 31, 1986 for $29,400 with Xidex Common at 14 3/4 and $21,670 with Xidex Warrants at 4 3/8. Xidex Warrants dropped back to 3 1/8 on December 17, 1986 and on that date plaintiff purchased the first 5,000 Xidex Warrants represented in this litigation. After rising shortly to 5 1/4, Xidex Warrants came back to price 3 and plaintiff resumed purchases in September/October of 1987.

Plaintiff was mailed by Xidex the 1987 Annual Report to Shareholders in October, 1987. The description of the Warrant terms was similar to those expressed one year

before. Plaintiff purchased 15,000 Xidex Common on December 21, 1987 and continued accumulating Xidex warrants at lower prices.

On July 12, 1988, Xidex and Anacomp Acquisition Corporation [hereafter Anacomp], a wholly owned subsidiary of Anacomp, Incorporated, announced plans for a merger at price $10.00 for Xidex Common; subsequently on July 29, 1988 on the basis of a merger price of $9.25 for Xidex Common and certain Adjustment Conditions, Xidex Warrants became convertible to $9.25 stock by paying $20.415. On July 12, 1988, Xidex Common rose but Xidex Warrants dropped precipitously. Plaintiff sold his 15,000 Xidex Common but retained all of his Xidex Warrants.

Plaintiff alleges his first cause of action under §18(a) of the Securities and Exchange Act of 1934 [hereafter §18(a), [15 U.S.C. § 78r(a)]. In essence plaintiff claims that he read and relied on a

two sentence reference to the Xidex Warrants which was contained in Note 2 appearing in Xidex's 1986 and 1987 Annual Reports to the Shareholders [hereafter Annual Reports], in deciding to purchase the Xidex Warrants. Plaintiff further claims that because those two sentences contained no reference to the Section 11 Adjustment Provision of the Warrant Agreement [hereafter §11, WA] which allows for an adjustment of the terms of the Warrants in the event of, inter alia, a merger, the Annual Reports were false and misleading in violation of §18(a).

The Note at issue was part of the audited financial statements contained in Xidex's 1986 and 1987 Annual Report to Shareholders which was incorporated by reference in Xidex's 1986 and 1987 Form 10-K Reports [hereafter 10-Ks] filed with the Securities and Exchange Commission [hereafter SEC], and is attached as Exhibit A.

Plaintiff avers that if the Adjustment Conditions had been disclosed in the "filed" parts of the Annual Reports he would not have purchased Xidex Warrants and would have only bought Xidex Common.

Plaintiff alleges that he purchased the Warrants in reliance on Note 2 in the Annual Reports and that when the §11,WA was exercised in connection with the merger providing for the acquisition of Xidex by Anacomp, the Warrants became valueless.

Plaintiff also alleges that defendants violated SEC Regulation §210.4-01(a) [17 C.F.R. §210.4-01(a)] of the SEC Regulation S-X, [17 C.F.R. §210], which sets out requirements for financial statements under federal securities laws. Plaintiff alleges

that defendants' omission of the §11, WA Adjustment Provisions from Note 2 in the Annual Reports violated the requirement of the SEC Regulation § 210.4-01(a) that

"such further material information as is necessary to make the required statements, in the light of the circumstances under which they are made, not misleading," be added to any statement furnished as a minimum requirement under SEC Regulation S-X.

Lastly, plaintiff alleges that defendants violated § 29(b) of the Securities and Exchange Act of 1934 [hereafter § 29 (b)], [15 U.S.C. § 78cc(b)], because the Warrant Agreement is a contract and defendants' violation of § 18(a) in the performance of that contract violates the provisions of § 29(b) that:

> Every contract made in violation of any provision of this chapter or of any rule or regulation thereunder, and every contract (...) heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this chapter or any rule or regulation thereunder, shall be void...

In order for this advisory opinion to be of the most benefit to the parties, the

Court will deal individually with each of the following legal issues listed in the Joint Report as being genuinely in dispute:

(a) WHETHER OR NOT THE PORTIONS OF XIDEX'S ANNUAL REPORTS INCORPORATED BY REFERENCE IN XIDEX FORM 10-KS FILED WITH THE SEC ARE THEMSELVES A "FILED" DOCUMENT WITH THE SEC FOR PURPOSES OF SECTION 18(a) OR WHETHER IT IS THE FORM 10-KS, IN TOTO, WHICH ARE THE FILED DOCUMENT?

Plaintiff argues that under SEC Regulation § 240.14c-3(b) [17 C.F.R. §240.14c-3(b)] the portion of the Annual Reports requested to be incorporated in the "filed"

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10-Ks became subject to the liabilities of § 18(a). This included the Note about Warrants at issue in this case. The relevant portions of SEC Regulation §240.14c-3(b) are:

> The report is not deemed to be "filed" with the Commission or subject ... to the liabilities of section 18 of the Act, except to the extent that the registrant specifically ... incorporates it in... other filed report by reference.

Central to plaintiff's argument is the assertion that the portion of the Annual Reports incorporated by reference into the 10-Ks is subject to § 18(a) "in isolation." In fact, plaintiff goes as far as to argue that a single page of the Annual Reports, page 18 of the 1986 Annual Report, which contains the note in question and was incorporated by reference into the 10-K, is a filed document and subject to § 18 "in isolation."

Defendants counter that those portions of the Annual Reports incorporated by reference into the 10-Ks became part of the whole: the filed 10-K, and are not deemed filed "in isolation" as plaintiff contends. Defendants point out that no case has been found which supports plaintiff's contention, and that it is the 10-Ks "in toto" which are the filed document.

The plaintiff argues that if Congress had wanted to include an "in toto" inter-

pretation it had the opportunity to do so, did not, and rather than seeking to limit the protection of investors by an "in toto" interpretation, the intent of Congress since the Securities and Exchange Acts were written has been to increase the protection afforded to investors. Plaintiff

[6]

further argues that the implications of the "in toto" theory are contrary to Congressional intent since a misleading statement incorporated into a 10-K could be rendered not misleading by accurate information contained elsewhere in the 10-K and thus corporations would be licensed to mislead or misrepresent at will.

Plaintiff also makes an argument that even if an "in toto" theory prevailed, it can not be applied in this particular case because, according to § 18(a), a statement must be judged "at the time" it was made, and the allegedly misleading statement in

all

the Annual Reports was published prior to the filing of the 10-K. However, if plaintiff's theory, no matter how attractive, was accepted, it could lead to the result that if, prior to a statement being incorporated into a filed document, a person relied on the statement, he could prevail in a § 18(a) action on a statement that, at the time he relied on it, was not in any way a filed document, or even part of a filed document. This flies in the face of the concept discussed later in this opinion that it is the knowledge that a document has been filed with the SEC that justifies reliance on the document under § 18(a), Wachovia Bank & Trust v. National Student Marketing, 461 F. Supp. 999, 1006 n.13 (D.D.C. 1978), rev'd on other grounds, 650 F.2d 342 (D.C. Cir. 1980).

This Court is of the opinion that the "in toto" theory must in this instance prevail. It seems clear, as defendants

argue, that § 18 liability is intended to serve the purpose of "encouraging use of and reliance upon records filed with the

[7]

S.E.C.," Ross v. A.H. Robins Co., 607 F.2d 545, 556 (2nd Cir. 1979), cert. denied, 446 U.S. 946 (1979).

The Annual Reports are certainly not filed documents, Heit v. Weitzen, 402 F.2d 909 (2nd Cir. 1968), cert. denied, 395 U.S. 903 (1969), and therefore plaintiff had no cause of action under § 18(a) based on the Annual Reports alone. It was not until the portions of the Annual Reports were incorporated by reference into a filed document, the 10-Ks, that the possibility of a § 18 (a) cause of action materialized for the plaintiff. However, the plain meaning of "incorporate by reference" precludes predication of § 18(a) liability on the note in question "in isolation" as plaintiff urges.

Webster's Dictionary defines "incorporate" as "to unite or work into something already existent so as to form an indistinguishable whole", WEBSTER'S NINTH NEW COLLEGIATE DICTIONARY 611 (1985). Once incorporated into the 10-K, the note from the financial report portion of the Annual Report became united or submerged into the rest of the 10-K and hence the 10-K "in toto" must be looked to for liability under § 18(a).

To rule otherwise would be to allow persons who rely on a very small part of the filed document, in this case a single Note, and are misled by the narrow and distorted view of the whole they thereby develop, to recover under § 18(a).

(b) WHETHER OR NOT THE OMISSION OF THE MENTION OF THE SECTION 11(a) ADJUSTMENT PROVISION OF THE 1986 XIDEX WARRANT AGREEMENT FROM XIDEX ANNUAL REPORTS IS "MATERIAL" UNDER REGULATION § 210.4-01(a) AND SECTION 18(a), AND FALSE AND MISLEADING IN LIGHT OF THE CIRCUMSTANCES SET FORTH AT PAGES 7,8,11,12 AND 13 OF THE JOINT

REPORT OF THE PARTIES?

§ 13(a) of the Securities and Exchange Act of 1934 [hereafter § 13(a)], [15 U.S. C. § 78m(a)] requires in pertinent part that:

> (a) Every issuer of a security registered pursuant to section 12 shall file with the Commission, in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate for the proper protection of investors and to insure fair dealing in the security-
>
> (1) Such information and documents (...) as the Commission shall require to keep reasonably current the information and documents required to be included in or filed with an application or registration statement filed pursuant to section 12 ....
>
> (2) Such annual reports (...), certified if required by the rules and regulations of the Commission by independent public accountants, and such quarterly reports (...), as the Commission may prescribe.

SEC Regulation § 210.4-01(a) provides in pertinent part that:

> (a) Financial statements should be filed in such form and order, and should use such generally accepted terminology, as will best indicate their significance and character in the light of the provisions applicable thereto. The information required

with respect to any statement shall be furnished as a minimum requirement to which shall be added such further material information as is necessary to make the required statements, in the light of the circumstances under which they are made, not misleading.

(1) Financial statements filed with the Commission which are not prepared in accordance with generally accepted accounting principles will be presumed to be misleading or inaccurate, despite footnote or other disclosures, unless the Commission has otherwise provided. This article and other articles of Regulation S-X provide clarification of certain disclosures which must be included in any event, in financial statements filed with the Commission.

§ 18(a) provides in pertinent part that:

(a) Any person who shall make or cause to be made any statement in any application, report, or document filed pursuant to this chapter or any rule or regulation thereunder or any undertaking contained in a registration statement ..., which statement was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, shall be liable to any persor (not knowing such statement

was false or misleading) who in reliance upon such statement, shall have purchased or sold a security at a price which was affected by such statement, for damages caused by such reliance,

> unless the person sued shall prove he acted in good faith and had no knowledge that such statement was false or misleading.

Plaintiff asserts in his briefing and at Summary Trial that reports required to be filed under § 13(a) are subject to SEC rules and regulations, such as SEC Regulation S-X and S-K, and that the financial statement portion of the Annual Report which was incorporated into the Form 10-K did not conform to the disclosure requirements of § 13(a). However, the annual report required by § 13(a) is the Form 10-K, not the Annual Report to Shareholders which was prepared for the security holders as required by Regulation § 240.14c-3. Hence to analyze defendants' compliance with § 13(a) disclosure requirements by looking only at the financial portion of Annual Report to Shareholders is clearly erroneous. The Form 10-K in its entirety must be looked at to determine compliance

with § 13(a) disclosure requirements.

As to the materiality of the omission of § 11(a), WA from the Annual Reports, plaintiff relies on SEC Regulation S-K requirements to show materiality. Specifically, plaintiff refers to SEC Regulation § 229.202(c) [17 C.F.R. §229.202(c)] which states:

> (c) Warrants and rights. If the securities described are to be offered pursuant to warrants or rights state:
> (1) The amount of securities called for by such warrants or rights;
> (2) The period during which and the price at which the warrants or rights are exercisable;
> (3) The amount of warrants or rights outstanding;
> (4) Provisions for changes to or adjustments in the exercise price; and
> (5) Any other material terms of such rights or warrants.

[10]

Plaintiff argues that Regulation S-K requirements, including SEC Regulaton § 229.202(c)(4)&(5), explicitly state that provisions for changes to or adjustments in the exercise price are material and must be stated. However, Regulation S-K

by its terms does not apply to financial statements and therefore would not apply to the portions of the financial statements in the Annual Reports in question:

> §229.10 General.
> (a) Application of Regulation S-K. This part ... states the requirements applicable to the content of the non-financial statement portions of:
> (1) Registration statements under the Securities Act ... and
> (2) ... annual or other reports under sections 13 ... annual reports to security holders ....
>
> 17 C.F.R. § 229.10.

With regard to SEC Regulation § 229.202 (c)(4)&(5), defendants argue this regulation does not apply to financial statements or Annual Reports. Instead, defendants rely upon SEC Regulation § 210.4-08 (i) [17 C.F.R. § 210.4-08(i)] which sets forth the information required to be disclosed in financial statements filed as part of 10-Ks with regard to Warrants.

SEC Regulation § 210.4-08(i) states:

> (i) Warrants or rights outstanding Information with respect to warrants or

rights outstanding at the date of the related balance sheet shall be set forth as follows:

(1) Title of issue of securities called for by warrants or rights.
(2) Aggregate amount of securities called for by warrants or rights outstanding.
(3) Date from which warrants or rights are exercisable.
(4) Price at which warrant or right is exercisable.

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Significantly, that controlling provision does not mention or require the information required by SEC Regulation § 29.202 (c) (4)&(5).

Defendants assert that Xidex disclosed all that was required to be disclosed by SEC REGULATION § 210.4-08(i) concerning the Warrants in the portions of financial statements of the Annual Reports which were incorporated in the 10-Ks. A comparison of the financial statement to this controlling provision reveals that there has been substantial compliance with the

SEC regulation.

Section 18(a) [Liability for misleading statements]:

> Any person who shall make or cause to be made any statement in any application, report, or document filed pursuant to this chapter or any rule or regulation thereunder or any undertaking contained in a registration statement..., which statement was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, shall be liable to any person (not knowing that such statement was false or misleading) who, in reliance upon such statement, shall have purchased or sold a security at a price which was affected by such statement, for damages caused by such reliance, unless the person sued shall prove that he acted in good faith and had no knowledge that such statement was false or misleading.

Defendants argue that under the circumstances and in the light in which Xidex made its statements in the portion of the financial statements of the Annual Reports which were incorporated into the 10-Ks, the omission of the full terms of the Warrant Agreement was neither material nor misleading under § 18(a).

In particular, defendants contend that

the omission in question was not false or misleading in light of the omission being made in a financial statement Note dealing with and entitled "Acquisitions", not Warrants. Defendants point out that the Note

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concerned the purchase of corporations acquired by Xidex, and that Warrants were only mentioned tangentially insofar as they were part of the purchasing vehicle for the acquisitions. The details of the Warrant Agreement omitted from the Note were not, according to the defendants, material to the topic of the Note concerned, namely "Acquisitions".

The "in the light of the circumstances under which they are made" language in § 18(a) is also found in SEC Regulation § 210.4-01(a) [17 C.F.R. §210.4-01(a)], which is part of SEC Regulation S-X. and states in part:

(a) Financial statements should be

> filed in such form and order, and should use such generally accepted terminology, as will best indicate their significance and character in the light of the provisions applicable thereto. The information required with respect to any statement shall be furnished as a minimum requirement to which shall be added such further material information as is necessary to make the required statements, in the light of the circumstances under which they are made, not misleading.

This Court is of the opinion that plaintiff has failed to show that "in the light of the circumstances" the omission of the Adjustment Provisions from Note 2 was false or misleading with respect to a material fact.

(c) WHETHER OR NOT THERE IS A PRIVATE RIGHT OF ACTION UNDER SEC REGULATION § 210.4-01(a)?

Plaintiff argues that there is a private right of action for violations of §13(a) [Filings required by issuers of securities] under Kaminsky v. Abrams, 281 F. Supp. 501, 505 (S.D.N.Y. 1968), and that since SEC Regulation § 210.4-01(a) is one

of the rules and regulations that "fall" under § 13, there is a private right of action under § 18(a) for violation of Regulation § 210.4-01(a). Plaintiff cites IN RE PENN CENTRAL SECURITIES LITIGATION, 357 F. Supp. 869, 876 (E.D.Pa. 1973), for the proposition that § 18(a) is the exclusive remedy for violation of § 13(a). Plaintiff's reliance on this case is misplaced because the District Court, in addition to holding that § 18(a) is the exclusive remedy for violations of § 13(a), also concluded that "no implied right or action exists under § 13(a)." IN RE PENN CENTRAL SECURITIES LITIGATION, at 876.

Defendants argue that the Courts have not recognized a private right of action under Regulation 210.4-01(a). Defendants rely upon Cort v. Ash, 422 U.S. 66 (1975), wherein a stockholder in Bethlehem Steel Corporation brought an action on behalf of himself and, derivatively, on behalf

of Bethlehem, seeking derivative damage relief and injunctive relief because of advertisements in connection with the 1972 Presidential election that Bethlehem corporate directors had authorized from general corporate funds in alleged violation of 18 U.S.C. § 610 [hereafter § 610], which prohibits corporations from making contributions or expenditures in connection with specified federal elections. In reversing a Court of Appeals decision that a private cause of action was proper to remedy violation of § 610, the Supreme Court set forth four factors to be considered by a court in determining whether a private right of action is implicit in a given statute. The four factors are (1) is the plaintiff "one of the class for whose

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especial benefit the statute was enacted," (2) "is there any indication of legislative intent, explicit or implicit, either

to create such a remedy or deny one," (3) "is it consistent with the underlying purposes of the legislative scheme to imply such a remedy for the plaintiff," and (4) "is the cause of action one traditionally relegated to state law." Cort, 422 U.S. at 78. Accordingly, defendants contend that a private cause of action should not be implied in the instant case because plaintiff is not one of the class for whose benefit the regulation was enacted. Defendants further contend that the accounting rules provided by SEC Regulation S-X, which includes SEC REgulation § 210.4-01(a), are for the benefit of those preparing and filing financial statements with the SEC, not those individuals purchasing securities based on financial statements. Defendants also cite Sanders v. Thrall Car Mfg. Co., 582 F. Supp. 945 (S.D.N.Y. 1983), for the proposition that the courts have implied no private right

of action under § 13(d) "and similar reporting provisions in the 1934 Act", Sanders at 960-61.

Given that "[i]n recent years, the Supreme Court has pursued increasingly restrictive approach to implying private remedies," Sanders, at 959, it is this Court's opinion that there is no private right of action under § 13(a). However, even if this Court were to find to the contrary, it would not aid the plaintiff, because by his own argument, §18(a) is the exclusive remedy for violation of § 13(a). The plaintiff would have come full circle back to having to prove his case under §18(a).

[15]

(d) WHETHER OR NOT PLAINTIFF'S CLAIM OF RELIANCE IS LEGALLY SUFFICIENT UNDER SECTION 18(a)?

Plaintiff claims that he has met all of the conditions required by §18(a) by: (1) directly relying on the "filed" part of the 1986 and 1987 Annual Reports, (2)

having been misled by the omission of the § 11, WA Adjustment Provisions about which he had no knowledge at the time, (3) purchasing warrants in reliance on these misleading statements when he would not have purchased them otherwise, and (4) suffering financial loss as a result. Plaintiff specifically states that he does not claim that he knew at the time of his reading the Annual Reports that they were "filed". This becomes very important in the light of defendants' argument that reliance under § 18(a) is only established where the plaintiff can show that he knew at the time of his purchase of securities that the document on which he claims to have relied was filed with the SEC. Defendants rely upon Wachovia Bank & Trust v. National Student Marketing, 461 F. Supp. 999, 1006, n. 13 (D.D.C. 1978), rev'd on other grounds, 650 F.2d 342 (D.C. Cir. 1980), wherein purchasers of stock brought pri-

vate federal securities law litigation against corporation, accounting firm, individual accountants and attorneys claiming that there was a conspiracy to defraud and violation of applicable federal securities laws in connection with purchase of common stock. Among other things the defendants contended that § 18(a) provided a remedy for misstatements and omissions alleged by plaintiffs since most if not all of the materially false and misleading statements were substantially contained

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in documents filed with the SEC. In holding that "absent reliance upon the filing of the statements with the Commission, § 18(a) is inapplicable," Wachovia, at 1006, the District Court for the District of Columbia noted:

> It is unclear whether reliance must be on the actual document filed with the SEC, or whether reliance on a copy of such document would suffice. The latter seems to be the more reasonable

> position since it is the knowledge that it has been filed with the Commission that justifies reliance on the document.

Wachovia, at 1006 n.13.

Plaintiff alleges that he had relied on the Annual Reports as he often does in his investments, that he had also relied upon the high opinion of the management that he had read about, that he had carefully investigated Xidex as was his custom, that he had maintained daily records and charts on the prices of Xidex common and Xidex warrants, that he did not have any doubts about the adequacy of defendants' description of the Warrants, that he did not intentionally refuse to investigate this description because he did not perceive a risk, and that he had no idea that material facts were omitted.

Defendants argue as noted above, that reliance under § 18(a) is only established where the plaintiff can show that he knew

at the time of his purchase of securities that the document on which he claims to have relied was filed with the SEC, citing Wachovia, at 1006 n.13. This clearly plaintiff cannot show. Indeed he has said that he does not claim to know at the time that the portions of the Annual Reports were filed. Instead, plaintiff argues that

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Wachovia and the other cases cited by defendants do not stand for the proposition that he must know at the time he purchases his securities that the document he is relying on is filed.

Plaintiff's argument serves to point out that other courts have not specifically ruled that a person must have knowledge that the document relied on is a filed document prior to purchasing securities. Nevertheless, it is the opinion of this Court that plaintiff must show that he knew at the time he purchased the War-

rants that the document he was relying on was filed with SEC in order to prevail un- § 18(a). The Court arrives at this opinion based on the reasoning that "it is the knowledge that it has been filed with the Commission that justifies reliance on the document" Wachovia, at 1006, n.13. See also, Ross, at 556 [the scope of § 18 is in "furthering the narrow and particularized objective of encouraging use of and reliance upon records filed with the SEC by expressly authorizing damage suits against those who make them depositories of materially false and misleading statements."] Since plaintiff had no knowledge of the filing, he is not justified in his reliance and should not be allowed to recover under § 18(a).

Defendants further rely upon Bromberg & Lowenfels, IV Securities Fraud and Commodities Fraud, § 8.4(469) (1989) for the proposition that in order for plaintiff to

state a case under § 18(a), he must plead: (1) that he knew that the document relied upon was filed with the SEC, and (2) that he did not know it was false or misleading when he bought or sold in reliance on it. [18]

Clearly plaintiff has failed Bromberg's first test, but defendants argue that plaintiff has also failed Bromberg"s second test because plaintiff did not allege that he did not know the statement was false or misleading, only that he had no knowledge of the material fact that was omitted from the description. However, the complaint states, "[p]laintiff alleges that he would not have purchased the warrants had he known of the omitted fact in question". Complaint, p. 15. Coupled with plaintiff's statement on page 18 of the complaint that "plaintiff alleges that he bought the warrants in reliance upon the Xidex descriptions of the terms, without

knowledge of the material fact omitted from the description" it seems clear to this Court that plaintiff indeed is alleging that he did not know the statement was false or misleading when he purchased his Warrants.

Defendants go on to argue that plaintiff could not in "good faith" claim to have had "no knowledge" that the statement would necessarily have been misleading as a source of information for the terms of the Warrant Agreement because that subject was irrelevant to the "Acquisitions" subject matter of Note 2. This argument appears to go whether or not the statement was misleading in light of the circumstances under which it was made, rather than to whether plaintiff had no knowledge that the statement was misleading. As this Court understands it, the test is whether plaintiff had knowledge that the statement was false and misleading, not

whether he should have known that the statement was false and misleading. Everything in the case points to the fact that

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plaintiff did not in fact know that the statement was misleading.

Be that as it may, it is clear to this Court that plaintiff cannot show the requisite reliance required to recover under § 18(a) since he did not know that at the time he "relied" on the financial statements of the Annual Reports that they had been incorporated into a "filed" Form 10-K Report.

(e) WHETHER OR NOT PLAINTIFF'S ALLEGED LOSSES WERE THE PROXIMATE RESULT OF (i) THE OMISSION OF THE SECTION 11 PROVISION FROM XIDEX'S ANNUAL REPORTS AND (ii) XIDEX'S INVOCATION OF THE SECTION 11 PROVISION IN CONNECTION WITH THE MERGER?

Plaintiff starts out his argument on this issue by quoting a definition of proximate cause from Swenson v. Engelstad,

626 F.2d 421, 426 (5th Cir. 1980) [action brought to recover damages sustained as a result of purchase of unregistered securities wherein Court of Appeals held that under § 12(1) of the Securities Act of 1933, one who parts with title to securities in exchange for consideration is a seller for purposes of § 12(1) and to such a person, the proximate cause test is inapplicable and therefore trial court erred in submitting special interrogatory with definition of proximate cause to the jury]. Plaintiff then quotes Huddleston v. Herman & Maclean, 640 F.2d 534,549 (5th Cir. 1981) [securities litigation under § 10(b) of the Securities Exchange Act of 1934, wherein the Court of Appeals held that to prevail in a Rule 10b-5 action, the plaintiffs must establish that their economic loss was proximately caused by the fraudulent misstatements and omissions

in the prospectus] to define "transactional causation" and "loss causation", but doesn't tie these into proximate cause. Plaintiff alleges that the omission of the § 11 WA Adjustment Provisions in the Annual Reports was the proximate cause of the transactions and that had he known about the adjustment provisions, he would not have purchased the Warrants because "in a period of time with so many mergers such an event as did happen was foreseeable." Plaintiff's Memorandum Briefing Legal Issues Set Forth in Joint Report of Parties Filed on January 29, 1990 at 22. Plaintiff then notes that the proximate cause of loss was defendants' invocation of the § 11, WA Adjustment Provision in connection with the merger. Lastly, plaintiff quotes Kaufman v. Chase Manhattan Bank, N.A., 581 F. Supp. 350, 355 (S.D.N.Y. 1984), for the proposition that "where the alleged misrepresentations could be found to have

induced both the purchase and the retention of the investment, proximate cause has been established."

Defendants start out by asserting that § 18(a) only applies where it is shown that the plaintiff purchased or sold a security at a price which was affected by a false or misleading statement, Ross, at 551, and that in the instant case plaintiff can adduce no evidence that the market price of the Warrants was affected by the purchase or sales by persons who read and relied on the statement in the Annual Reports which omitted the Adjustment Provision. Furthermore, defendants emphasize that the market was well aware of the Adjustment Provision as evidenced by the

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plaintiff's own data that the price of Warrants dropped sharply on the date of the public announcement of the merger.

Next, defendants argue that plaintiff's

injuries proximately resulted from his own failure to avail himself of the information publicly available to him regarding the express terms of the Warrant Agreement (i.e. the Form 10-Ks, registration and offering documents, the Warrants themselves, etc.).

Plaintiff's argument is a classic "but for" one. But for defendants omitting the Adjustment Provisions from the financial statement in the Annual Reports, plaintiff would not have purchased the Warrants and would not have been injured when the merger made the Warrants valueless because of the Adjustment Provisions. Defendants, however, correctly point out that under § 18(a) the price plaintiff paid must have been affected by the misleading statement, Ross, at 551, and in the instant case that just is not true. Indeed, plaintiff admits that he can not prove that the price of the Warrants at the time he purchased

was affected by the allegedly misleading statement. Defendants' argument is not as persuasive with respect to the plaintiff's injuries being proximately caused by his failure to investigate other public information. Although plaintiff's loss may very well be the result of his not availing himself of information readily available in the 10-Ks and other documents filed with the SEC, § 18(a) requires a lack of knowledge of the misrepresentation on plaintiff's part for him to recover, not a lack of knowledge after investigation, reasonable or otherwise.

[22]

(f) WHETHER OR NOT THE INCORPORATION OF THE XIDEX WARRANT AGREEMENT IN XIDEX'S FORM 10-KS FILED WITH THE SEC NEGATES SECTION 18 LIABILITY?

Plaintiff argues that there is no mention of a warrant agreement in § 18(a) and that there is also no mention that reading the Warrant Agreement is a prior con-

dition before purchasing a warrant or filing a claim under § 18(a). Defendants do not claim otherwise.

Next plaintiff recapitulates a prior argument that incorporation of the Xidex Warrant Agreement in the Form 10-K has no effect on whether the alleged omission violated § 13. Plaintiff,s invocation of § 13 is in error. That section governs which periodical and other reports an issuer of securities must file, including the Form 10-K. Surely any analysis of compliance with § 13 would have to involve all the information included in the Form 10-K. The real question is whether the omission violated § 18(a) and that has been discussed previously.

Defendants state that to the extent that plaintiff claims to have relied on the Form 10-K reports, there was in fact no omission of the terms of the Warrant Agreement since the Warrant Agreement it-

self was incorporated therein. This Court agrees with defendants and notes that it is very clear that plaintiff did in fact not rely on the Form 10-K reports because he never saw the Form 10-Ks until after he had purchased the Warrants, Erath Depo. pp. 105-106 and 113-114.

[23]

(g) WHETHER OR NOT PLAINTIFF'S FAILURE TO READ AND RELY UPON XIDEX'S FORM 10-KS FILED WITH THE SEC IN PURCHASING THE XIDEX WARRANTS NEGATES SECTION 18 LIABILITY?

Plaintiff starts his argument with the statement that there is no § 18(a) requirement that plaintiff must have read the Form 10-K. Plaintiff argues without citing authority that other courts treating alleged violations of § 18(a) have required plaintiff to show actual "eyeball reliance" upon the 10-K. From that he extrapolates that his own actual "eyeball reliance" on Note 2 on page 18 of the Annual Reports to Shareholders is suffici-

ent to trigger a cause of action under § 18(a), despite the fact that he had no "eyeball reliance" on the entire filed 10-K.

Defendants argue that the law requires that in order to establish liability under § 18, the plaintiff must both: establish reliance on the actual 10-K report, and also have knowledge when making his purchases that the document relied on was filed. Defendants cite Wachovia, at 357 [actual reliance required]; Ross, at 552-53 [must have knowledge and reliance]; Heit, at 916 [reliance on actual 10-K Report is a prerequisite for § 18 liability, and allegations must be that the misrepresentations are "contained in 10K reports"]; Beebe v. Pacific Realty Trust, 99 F.R.D. 60, 70 (1983) [must have actual reliance on the filed document, and constructive reliance is not sufficient]; Jacobson v. Peat, Marwick, Mitchell & Co.,

445 F. Supp. 518, 525 (S.D.N.Y. 1977)[reliance must be on the actual filed form].

[24]

Plaintiff makes a good point in distinguishing other cases where the courts refer to the need for reliance on the "actual 10-K", from the instant case where the issue is reliance on the "actual 10-K" as a whole, versus reliance on part of the 10-K report "in isolation". Apparently, other courts have not had to split this particular hair before and have up to now been dealing with "eyeball reliance" on the Form 10-K as a whole, versus "constructive reliance" on the Form 10-K as a whole. Plaintiff does not claim that "constructive reliance" is good enough to recover, but rather that "eyeball reliance" on part of the 10-K is all that is necessary.

That brings the Court full circle back to the central question of whether or not

the portions of the Annual Report incorporated by reference in the Form 10-Ks filed with the SEC are themselves separate and individual "filed" documents for purposes of § 18(a) or whether it is the Form 10-Ks, "in toto", which are the filed document. Again, it is this Court's opinion that we must look to the Form 10-Ks "in toto" for recovery under § 18(a).

Even if this Court were to accept plaintiff's argument, the defendants would still prevail on this issue because the fact is that plaintiff did not know that the financial statements in the Annual Reports were filed at the time that plaintiff claims to have relied on them. As defendants point out, plaintiff must have known that the document was filed as a basis for relying on the document, Wachovia, at 1006.

[25]

(h) WHETHER OR NOT THE PRICE OF THE XIDEX WARRANTS WHICH PLAINTIFF PURCHASED WAS

AFFECTED BY THE OMISSION FROM THE ANNUAL REPORTS OF THE SECTION 11 ADJUSTMENT PROVISION?

This issue has been discussed previously under (e). Briefly, plaintiff argues that he does not have any means of knowwhether or not the price of the Warrants was affected by the omission, and that the particular price in question is not part of his claim, because the relief he seeks is rescission, recovery of the actual price paid. Plaintiff misses the point that § 18(a) requires that he "shall have purchased or sold a security at a price which was affected by such statement' in order to recover under § 18(a).

Defendants point to the collapse of the value of the Warrants on the day the letter of intent of merger was signed to show that the market price of the Warrants (including those purchased by plaintiff) had "always" reflected the investing community's knowledge of the Adjustment Pro-

vision. The Court is not sure the "always" is entirely justified, but obviously plaintiff has failed to carry his burden of showing the price he paid was affected by the omissions, and the timing of the collapse of the market price is indicative that the price plaintiff paid was not affected by the omissions.

(i) WHETHER OR NOT DEFENDANTS' ACTIONS WITH RESPECT TO THE DISCLOSURE OF THE SECTION 11 ADJUSTMENT PROVISIONS WERE UNDERTAKEN IN GOOD FAITH?

Plaintiff argues that defendants knew, or

should have known, that Reg. S-K in Reg.§229.202 requires to be stated: "(4) Provisions for changes to or adjustments in the exercise price; and (5) Any other material terms of such rights or warrants." However, Reg. S-K governs the requirements applicable to the non-financial statement portions of registration statements under the Securities Act, registration statements under

§ 12, annual or other reports under § 13 and 15(d), annual reports to security holders and proxy and information statements under § 14, and any other documents required to be filed under the Exchange Act and specifically does not apply to financial statements. The omissions plaintiff complains of were in the financial statements of the Annual Reports. Plaintiff also argues that financial statements filed with the Commission which are not prepared in accordance with generally accepted accounting principles will be presumed to be misleading. However, plaintiff has not shown that the financial statements were not prepared in accordance with generally accepted accounting principles. Defendants specifically allege that the financial statements were prepared in accordance with generally accepted accounting principles and, absent further evidence from plaintiff on this issue, the

Court must agee with defendants.

Plaintiff uses the warnings printed on the face of the Warrant Certificates, ("subject to the conditions set forth herein and in the Warrant Agreement" and "[t]he Exercise Price [is] ... subject to adjustment upon occurrence of certain events set forth in the Warrant Agreement")

[27]

as evidence that the defendants knew the Adjustment Provisions were material and therefore should have been disclosed in the Annual Reports. The reverse side of the Warrants also contained a statement that "[the] Warrant Agreement provides that, upon the occurrence of certain events, the Exercise Price set forth on the face hereof may, subject to certain conditions, be adjusted." To the contrary, defendants argue that the warnings are evidence of their good faith by informing the marketplace of the Adjustment Provis-

ions. Again, this Court is of the Opinion that the defendants have the right of it.

Defendants argue that good faith of a defendant in a § 18 action is an absolute bar to liability, citing Ross, at 556, wherein shareholders of a corporate manufacturer of pharmaceutical and consumer products brought class action against corporation and others, alleging violation of § 10(b) of the Securities and Exchange of 1934 [hereafter § 10(b)], [15 U.S.C. 78j], and rules promulgated thereunder, claiming a failure to reveal full information concerning a product of the company called the "Dalkon Shield." In holding that a cause of action may be maintained under § 10(b) despite the fact that the alleged defendants' conduct constituted a violation of § 18, the Court pointed out that under § 18, a plaintiff "must merely plead and prove that a document filed with the Commission contains a mat-

erial misstatement or omission" and "if he can show reliance on that statement, liability is established, unless by the very term of section 18, the person sued

[28]

shall prove that he acted in 'good faith and had no knowledge that such statement was false and misleading.'" Ross, at 556.

Defendants further allege that they "fully and conspicuously" informed the marketplace of the terms on which the Warrants were sold by printing the Adjustment Provisions on the face of the warrants, registering the Warrants along with the Warrant Agreement with the Commission, making copies of the Warrant Agreement freely available to the public, and incorporating the Warrant Agreement in the 10-K Reports. All this, defendants claim, shows their "evident good faith". Aside from the fact that the Adjustment Provisions were not actually printed on the

face of the Warrants, this Court agrees.

(j) WHETHER OR NOT A CAUSE OF ACTION IS PROPERLY STATED UNDER SECTION 29(b), GIVEN PLAINTIFF'S CONCESSION THAT NEITHER THE XIDEX APRIL 16, 1986 WARRANT AGREEMENT NOR THE XIDEX WARRANT CERTIFICATES WAS AN ILLEGAL CONTRACT UNDER THE 1934 SECURITIES EXCHANGE ACT, AND INSTEAD, BASES HIS CLAIM ON THE ALLEGATION THAT IT WAS XIDEX'S PERFORMANCE OF THE XIDEX WARRANT CONTRACT WHICH WAS ILLEGAL?

§ 29(b) provides in pertinent part that:

> (b) Every contract made in violation of any provision of this chapter or of any rule or regulation thereunder, and every contract (...) heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this chapter or any rule or regulation thereunder, shall be void (1) as regards the rights of any person, who, in violation of any such provision, rule, or regulation, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision, rule, or regulation: Provided ...

The Court found the plaintiff's argument on this issue to be confusing, particularly as to what agreement or contract plaintiff is claiming is illegal. In the compliant plaintiff clearly states that it is the Warrant Agreement, but in his brief he alleges that his purchase of the Warrants is the contract in question. Plaintiff's brief alleges "[e]ither the purchase by plaintiff represents (a) a contract made in violation of the Act or (b) a performance under the contract which violated the Act." Plaintiff's Memorandum Briefing Legal Issues Set Forth in Joint Report of Parties at 29. At another point in his brief, plaintiff says in relation to his purchases that "there never was a lawful contract exercised between plaintiff and defendants." Plaintiff's Memorandum Brief-Legal Issues Set Forth in Joint Report of Parties at 29. At Summary Trial, plaintplainly stated that there never was any

contract between Xidex and him.

On these facts, there is no authority to support plaintiff's alternate theory that his purchase of the Warrants created a contract between Xidex and him, separate from any terms containde within the four corners of the Warrant Agreement. Instead, it is apparent that plaintiff must look to § 29(b)(2) for recovery under § 29(b) as a "person who, not being a party to such contract [Warrant Agreement], shall have acquired any right thereunder". Accordingly, the Warrant Agreement is the contract that the Court must focus on in analyzing plaintiff's claim under §29(b).

As to the Warrant Agreement, plaintiff expressly states that he is not alleging that the contract "by its own terms" is illegal. He instead argues that the con-

[30]

tract as performed violates the Act and he is entitled to rescission. The violat-

ion of the Act as he expresses it is that "the contract itself by the material omission of disclosing the Section 11 Adjustment Provisions has been made misleading to an investor who relied on the warrant description it was given." Plaintiff's Memorandaum Briefing Legal Issues Set Forth in Joint Report of the Parties at 29. The Court is not persuaded by this argument, because the Warrant Agreement did indeed contain the Adjustment Provisions.

In his brief, plaintiff also emphasizes that the violation is not collateral or tangential to the contract "between the parties." Then at Summary Trial, plaintiff argued that since there never was a contract between Xidex and him, the violation could not be collateral.

Defendants argue simply that plaintiff has not alleged that the Warrant Agreement is illegal, and his claimed illega-

lity that defendants failed to disclose in the Annual Reports to Shareholders a term of the contract (the Adjustment Provision) is collateral to the contract (the Warrant Agreement) and case law holds no § 29 right of rescission exists for such alleged collateral illegality, citing Slomiak v. Bear Stearns & Co., 597 F. Supp. 676, 681-82 (S.D.N.Y. 1984), [action brought by customer against securities broker alleging violation of § 10(b) and the credit information disclosure provisions of Rule 10b-16, and seeking rescission of customer's bond transactions pursuant to § 29(b), wherein District Court ruled that the remedy of rescission was foreclosed where the violation complained

of is collateral or tangential to the contract between the parties].

The question of whether the alleged violation is collateral is, as highlighted

by the defendants, a key issue.

Given that the Warrant Agreement itself spells out the Adjustment Provisions, this Court has a hard time seeing how the failure to disclose the Adjustment Provisions in a Note to the financial statements in Annual Reports to Shareholders can be anything other than collateral to the Warrant Agreement and thus not actionable in rescission.

CONCLUSIONS

In conclusion, it is the opinion of this Court that, for the reasons herein stated, the plaintiff's claim must fail.

As to plaintiff's cause of action under § 18(a), even if plaintiff were to be given the benefit of the doubt on the issues of the incorporated portions of the Annual Reports being "filed" documents, the defendants' statement being misleading, and plaintiff's reliance being sufficient,

plaintiff's case would still fail because he has failed to prove, and admits that he can not prove, that the price at which he purchased or sold the Warrants was affected by the allegedly misleading statements of the defendants as he is required to prove under §18(a). Additionally, it is

[32]

clear to this Court that defendants' good faith is an absolute bar to §18(a) liability in this case.

Plaintiff's cause of action for violation of SEC Regulation §210.4-01(a) likewise must fail because there is no private right of action for violation of Regulation §210.4-01(a), or §13(a) under which the regulation falls. Also, by plaintiff's own admission, §18(a) is the exclusive remedy for violation of §13(a), and having failed to prove a case under §18(a), plaintiff thus also fails under Reg. §210.4-01(a) and §13(a).

Finally, plaintiff's cause of action

for violation of § 29(b) is also without merit because the Warrant Agreement is, by plaintiff's own admission, not illegal, and plaintiff's claimed illegality in the performance of that contract (that defendants failed to disclose in Note 2 the § 11, WA) is collateral to the contract, and thus not actionable in rescission. Indeed, even if the Court had not found the failure to disclose the § 11, WA collateral to the contract, it has found that the failure did not violate § 18(a), and thus plaintiff is left with no violation of the Act or regulations thereunder on which to predicate recovery under § 29(b).

DATED this 8th day of June, 1990.

[Signed]
NANCY FIORA
UNITED STATES MAGISTRATE

APPENDIX B

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF ARIZONA

DOUGLAS J. ERATH, Plaintiff,	)	CIV 89-198 TUC ACM
vs.	)	
XIDEX CORPORATION, et al., Defendants.	)	O R D E R

IT IS ORDERED that the defendants' Motion for Summary Judgment is GRANTED. The Court adopts the Magistrate's Advisory Opinion as a basis for the granting of the Motion for Summary Judgment.

IT IS FURTHER ORDERED that Judgment be entered in favor of the defendants and against the plaintiff.

IT IS FURTHER ORDERED that the defendants' request for attorney fees is DENIED. The parties shall each bear their own costs.

Dated February 6, 1991.

(Signed.)
ALFREDO C. MARQUEZ
United States District Judge

APPENDIX C

UNITED STATES DISTRICT COURT

DISTRICT OF ARIZONA

DOUGLAS J. ERATH,

Plaintiff, JUDGMENT IN A CIVIL CASE

v.

XIDEX CORPORATION, et al., CIV-89-198-TUC-ACM

Defendants.

X Decision by Court. This action came on for consideration. The issues have been considered and a decision has been rendered.

IT IS ORDERED AND ADJUDGED that the defendants' Motion for Summary Judgment is granted.

IT IS FURTHER ORDERED that judgment is entered in favor of the defendants and against the plaintiff.

IT IS FURTHER ORDERED that the request

for attorneys fees is denied and the parties are to bear their own costs.

February 7, 1991 — RICHARD H. WEARE
Date — Clerk

cc: Erath, Iurino, Lawrence, ACM, J/B

(Signed.)
(By)Deputy Clerk, Renee Ludeke

APPENDIX D

NOT FOR PUBLICATION

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

DOUGLAS J. ERATH, Plaintiff-Appellant, v. XIDEX CORPORATION; CRAIG M. GENTNER; BERT L. ZACCARIA, Defendants-Appellees.	No. 91-15306 D.C. No. CV-89-00198-ACM
DOUGLAS J. ERATH, Plaintiff-Appellee, v. XIDEX CORPORATION; CRAIG M. GENTNER; BERT L. ZACCARIA, Defendants-Appellants.	No. 91-15460 D.C. No. CV-89-00198-ACM ORDER

Appeal from the United States District Court for the District of Arizona Alfredo C. Marquez, District Judge, Presiding

Argued and Submitted April 15, 1992
San Francisco, California

Before: HUG, TANG, and T.G. NELSON, Circuit Judges.

The district court order filed February 7, 1991 is AFFIRMED for the reasons stated in the Advisory Opinion of the magistrate filed June 11, 1990 and adopted by the district court on February 6, 1991. The request for attorney's fees is denied. Xidex is awarded its costs on appeal.

APPENDIX E

FILED
JULY 1 1992

NOT FOR PUBLICATION

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

DOUGLAS J. ERATH, Plaintiff-Appellant, v. XIDEX CORPORATION; CRAIG	)	No. 91-15306 D.C. No. CV-89-00198-ACM

M. GENTNER; BERT L. ZACCARIA,	)	
Defendants-Appellees.	)	
DOUGLAS J. ERATH,	)	
Plaintiff-Appellee,	)	No. 91-15460
v.	)	D.C. No. CV-89-00198-ACM
XIDEX CORPORATION; CRAIG M. GENTNER; BERT L. ZACCARIA,	)	ORDER
Defendants-Appellants.	)	

Appeal from the United States District Court for the District of Arizona

Before: HUG, TANG, and T.G. NELSON, Circuit Judges.

The panel as constituted in the above case has voted unanimously to deny the petition for rehearing and to reject the suggestion for a rehearing en banc.

The full court has been advised of the en banc suggestion and no judge of the court has requested a vote on it. Fed. R. App. P. 35(b).

The petition for rehearing is denied and the suggestion for a rehearing en banc is

rejected.

APPENDIX F

LIABILITY FOR MISLEADING STATEMENTS

[¶26,226] [Suits by Persons Relying on False or Misleading Statements]

Sec. 18(a) Any person who shall make or cause to be made any statement in any application, report, or document filed pursuant to this title or any rule or regulation thereunder or any undertaking contained in a registration statement as provided in subsection (d) of section 15 of this title, which statement was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, shall be liable to any person (not knowing that such statement was false or misleading) who, in reliance upon such statement, shall have purchased or sold a security at a price which was affected by such statement, for damages caused by such reliance, unless the person sued shall prove that he acted in good faith and had no knowledge that such statement was false or misleading. A person seeking to enforce such liability may sue at law or in equity in any court of competent jurisdiction. In any such suit the court may, in its discretion, require an undertaking for the payment of the costs of such suit, and assess reasonable costs, including reasonable attorneys' fees against either party litigant.

APPENDIX G

Article 4- Rules of General Application

[¶69,191] Form, Order, and Terminology

Reg.§210.4-01.(a) Financial statements should be filed in such form and order, and should use such generally accepted terminology, as will best indicate their significance and character in the light of the provisions applicable thereto. The information required with respect to any statement shall be furnished as a minimum requirement to which shall be added such further material information as is necessary to make the required statements, in the light of the circumstances under which they are made, not misleading.

(1) Financial statements filed with the Commission which are not prepared in accordance with generally accepted accounting principles will be presumed to be misleading or inaccurate, despite footnote of other disclosures unless the Commission has otherwise provided. This article and other articles of Regulation S-X provide clarification of certain disclosures which must be included in any event, in financial statements filed with the Commission.

(2) ... (not pertinent.)

APPENDIX H

[¶69,198] General Notes to Financial Statements

Reg. §210.4-08. If applicable to the person for which the financial statements

are filed, the following shall be set forth on the face of the appropriate statement or in appropriately captioned notes. The information shall be provided for each statement required to be filed, except that the information required by items (b),(c),(d),(e),and (f) shall be provided as of the most recent audited balance sheet being filed and for item (j) as specified therein. When specific statements are presented separately, the pertinent notes shall accompany such statements unless cross-referencing is appropriate.

.....(i) Warrants or rights outstanding. Information with respect to warrants or rights outstanding at the date of the related balance sheet shall be set forth as follows:

(1) Title of issue of securities called for by warrants or rights.

(2) Aggregate amounts of securities called for by warrants or rights outstanding.

(3) Date from which warrants or rights are exercisable.

(4) Price at which warrant or right is exercisable.

APPENDIX I

[¶24,203] Annual Report to Be Furnished Security Holders

Reg. §240.14c-3.(a) If the information statement relates to an annual (or special meeting in lieu of the annual) meeting, or written consent in lieu of such meeting, of security holders at which directors are to be elected, it shall be accompanied or preceded by an annual report to such security holders.

(1) The annual report shall contain the information specified in paragraphs (b)(1) through (b)(11) of Rule 14a-3 (§240.14a-3 of this chapter.)

.... (b) ...The report is not deemed to be "filed" with the Commission or subject to this regulation otherwise than as provided in this rule, or to the liabilities of Section 18 of the Act, except to the extent that the registrant specifically requests that it be treated as a part of the information statement or incorporates it in the information statement or other filed report by reference....

APPENDIX J

FORM 10-K

Annual Report Pursuant to Section 13 or

15(d) of the Securities Exchange Act of 1934

[¶31,102] GENERAL INSTRUCTIONS

..... G. Information to be Incorporated by Reference.

(1) Attention is directed to Rule 12b-23 [¶23,045] which provides for the incorporation by reference of information contained in certain documents in answer or partial answer to any item of a report.

(2) The information called for by Parts I and II of this Form (Items 1 through 9 or any portion thereof) may, at the registrant's option, be incorporated by reference from the registrant's annual report to security holders furnished to the Commission pursuant to Rule 14a-3(b) or Rule 14c-3(b) or Rule 14c-3(a) or from

the registrant's annual report to security holders, even if not furnished to the Commission pursuant to Rule 14a-3(b) or Rule 14c-3(a), provided such annual report contains the information required by Rule 14a-3.

Note.- In order to fulfill the requirements of Part I of Form 10-K, the incorporated portion of the annual report to security holders must contain the information required by Items 1-3 of Form 10-K, to the extent applicable.

APPENDIX K

[¶24,007]Information to Be Furnished

Security Holders

Reg. §240.14a-3 ... (b)(1) The report shall include, for the registrant and its subsidiaries consolidated, audited balance sheets as of the end of each of the two most recent fiscal years and audited statements of income and changes in financial position for each of the three most recent fiscal years prepared in accordance with Regulation S-X(Part 210 of this chapter), except that the provisions of Article 3 (other than §210.3-03(e), 210.3-04 and 210.3-20) and Article 11 shall not apply. ...

(11) Subject to the foregoing requirements, the report may be in any form deemed suitable by management and the information required by paragraphs (b)(5) to (b)(10) of this section may be presented in an appendix or other separate section of the report, provided that the attention of security holders is called to such presentation. ...

APPENDIX L

[¶69,101] Application of Regulation S-X (17 CFR Part 210)

Reg. §210.1-01.(a) This part (together with the Financial Reporting Releases (Part 211 of this chapter)) sets forth the form and content of and requirements for financial statements required to be filed as a part of: ....

(2) Registration statements under section 12 [Subpart C of Part 249 of this chapter], annual or other reports under sections 13 and 15(d) [Subparts D and E of Part 249 of this chapter], and proxy and information statements under section 14 of the Securities Exchange Act of 1934 except as otherwise specifically provided in the forms which are to be used for registration and reporting under these sections of this Act;...

(4) (b) The term "financial statement" as used in this part shall be deemed to include all notes to the statements and all related schedules. ...

APPENDIX M

[¶71,001] REGULATION S-K §229.1-General

Reg. §229.10.(a) Application of Regulation S-K. This part...states the requirements applicable to the content of the non-financial statement portions of:

...(2) Registration statements under section 12 (Subpart C of Part 249 of this chapter), annual or other reports under sections 13 and 15(d) (Subparts D and E

of Part 249 of this chapter), annual reports to security holders and proxy and information statements under section 14 of the Exchange Act (Part 240 of this chapter), and any other documents required to be filed under the Exchange Act, to the extent provided in the forms and rules under such Act. ...

APPENDIX N

[¶71,022] Regulation §229.202

..... (c) Warrants and rights. If the securities described are to be offered pursuant to warrants or rights state:

(1) The amount of securities called for by such warrants or rights;

(2) The period during which and the price at which the warrants or rights are exercisable;

(3) The amount of warrants or rights outstanding;

(4) Provisions for changes to or adjustments in the exercise price; and

(5) Any other material terms of such rights or warrants.

APPENDIX O

[¶26,591] Contracts Involving Violation of Act in Performance

Sec. 29(b) Every contract made in violation of any provision of this title or of any rule or regulation thereunder, and every contract (including any contract for listing a security on an exchange) heretofore or hereafter made the performance of which involves the violation of, or the continuance of any relationship or

practice in violation of, any provision of this title or any rule or regulation thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, or regulation, shall have made or engaged in the performance of any such contract, and...

APPENDIX P

REGULATION 14A-SOLICITATION OF PROXIES

[¶24,005] Definitions

Reg. §240.14a-1. Unless the context otherwise requires, all terms used in this regulation have the same meanings as in the Act or elsewhere in the general rules and regulations thereunder. ....

APPENDIX Q

XIDEX WARRANT AGREEMENT (Pertinent parts)

[p. 8] SECTION 11. Adjustment of Exercise Price, Number of Shares, or Number of Warrants. The Exercise Price, the number and kind of securities purchasable upon the exercise of each Warrant, and the number of Warrants outstanding shall be subject to adjustment from time to time upon the happening of the events enumerated in this Section 11.

(a) In case the Company shall at any time after the date of this Agreement (i) pay a dividend in shares of Common Stock or other stock of the Company or make a distribution in shares of Common Stock or such other stock to holders of all its

outstanding shares of Common Stock, (ii) subdivide the outstanding shares of Common Stock, (iii) combine the outstanding shares of Common Stock into a smaller number of shares of Common Stock, or (iv) issue by reclassification of its shares of Common Stock other securities of the Company (including any such reclassification in connection with a consolidation or merger in which the Company is the continuing corporation), the number and kind of shares purchasable upon exercise of each Warrant outstanding immediately prior thereto shall be adjusted so that the holder of each Warrant shall be entitled to receive at the same aggregate Warrant Exercise Price the kind and number of shares of Common Stock or other securities of the Company which he would have owned or have been entitled to receive after the happening of any of the events described above had such Warrant been exercised in full immediately prior to the earlier of the happening of such event or any record date with respect thereto. .....

[p. 9] ... An adjustment made pursuant to this paragraph 11(a) shall become effective immediately after the effective date of such event retroactive to the record date, if any, for such event....

[p. 21] SECTION 25. California Contract. This Agreement and each Warrant Certificate issued hereunder shall be deemed to be a contract made under the laws of the State of California and for all purposes shall be governed by and construed in accordance with the laws of such state applicable to contracts to be made and performed entirely within such state.

APPENDIX R

Xidex Annual Report - 1986

[p. 18] "Warrant Description"

Note 2-Acquisitions
In February 1985, the Company acquired all of the outstanding shares of Dysan Corporation (Dysan) in exchange for approximately 14,338,000 shares of Common Stock (valued at $12.00 per share) and cash of $7,400,000. In connection with the acquisition, the Company recorded goodwill of approximately $30,000,000 which is being amortized over 30 years. The Company also accrued for various pre-acquisition contingencies, primarily for rental payments and estimated selling costs of certain excess Dysan buildings. At June 30, 1985 and 1986, the accrual balance was $21,337,000 and $11,311,000, respectively, of which $6,071,000 and $7,730,00 was classified as current.

In March 1985, the Company acquired the minority shareholder interest in Xidex Magnetics Corporation (Xidex Magnetics) Common Stock in exchange for approximately 3,600,000 shares of Common Stock valued at $12.00 per share. In connection with this acquisition, the Company recorded goodwill of approximately $38,000,000 which is being amortized over 30 years.

During 1986, the Company acquired all the outstanding stock of TriMedia Corporation (TriMedia) and of Charlton Associates (Charlton) in exchange for Common Stock and Warrants. In connection with these acquisitions, the Company issued approximately 3,327,000 shares of Common Stock (valued at $14.00 per share), of which 59,000 shares are restricted, and

4,643,000 Warrants valued at $3.75 per unit. Each Warrant entitles the holder to purchase one share of Common Stock at $20.415 per share and expires on April 16,1993 or earlier if the average closing price of Common Stock exceeds $30.62 per share for 180 consecutive trading days. In connection with these two acquisitions, the Company recorded goodwill of approximately $56,000,000 which is being amortized over 30 years. ...

APPENDIX S

XIDEX FORM 10-K - 1986

[p. 18] INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

The Consolidated Financial Statements, together with Report thereon of Peat, Marwick, Mitchell & co., dated July 24, 1986, appearing on pages 15 to 23 of the Xidex Corporation 1986 Annual Report to Shareholders are incorporated by reference in this Annual Report on Form 10-K. With the exception of the aforementioned information, and information incorporated in Items 1,5,6,7, and 8, of this Form 10-K, the 1986 Annual Report to Shareholders is not to be deemed filed as part of this report. ...

APPENDIX T

January 17, 1989 Letter from Nancy K. Frank, Xidex Director of Legal Affairs and Corporate Counsel to SEC.

[p. 2] ...The Warrant Agreement contains

a customary term providing that upon the occurrence of a transaction, such as the Merger, in which Xidex survives as a corporation the Xidex Warrants cease to be exercisable for Xidex Comman Stock and instead become exercisable for the per share consideration received by the holders of Xidex Common Stock. The result is that when the price being paid for Xidex Common Stock is below the strike price of the Xidex Warrants, the Xidex Warrants become valueless. In the case of the Merger, pursuant to the Warrant Agreement the Xidex Warrants were automatically converted into the right to pay $20.415 (the strike price) to receive $9.25 (the price paid for Xidex Common Stock in the Merger). ...

APPENDIX U

Bromberg & Lowenfels IV Securities Fraud and Commodities Fraud, 1989

8.4(467) Plaintiff's Knowledge. ....

Another aspect of plaintiff's knowledge is important. He can maintain suit only if he bought or sold in reliance on the false or misleading filing. Therefore he must know of the filing. Presumably this means know of the information in the filing. Since few persons actually see the reports filed under the 1934 Act, a plaintiff may be able to satisfy the knowledge requirement by showing that he was familiar with the content of the report in some other form, say as reproduced by a broker, advisory service or newspaper, or as released by the company filing the report. ....

8.4(469) Pleading. A plaintiff employing

SEA §18(a) should plead

(1) He knew of the filing which was false or misleading (as a basis for relying on it) and

(2) He did not know it was false or misleading when he bought or sold in reliance on it. ....

If plaintiff sues more than a year after his purchase or sale (or perhaps even if he sues more than a year after the filing) he should plead that he could not have known that the statements in the filing were false or misleading until a date within a year of his instituting suit, and should plead supporting facts.